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SUPREME COURT U.S.

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 723

MEL DAR CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

In April 1950, the Mar-Tex Realization Corporation brought suit against Coy Burnett and his wife to enforce an alleged agreement by them to grant it an oil and gas lease on certain property. While the suit was pending, the Burnetts leased the property to the petitioner, a corporation owned by the Burnetts and their children. The petitioner, whose lease would be nullified should Mar-Tex prevail in the action, intervened in the suit. In August 1951, the trial court entered judgment that Mar-Tex was entitled to the lease but that the Burnetts and petitioner were entitled to reimbursement for amounts expended in developing the property. On appeal, the Texas Court of Civil Appeals reversed, holding that Mar-Tex had had no lease or contract to make a lease. That decision became final on December 17,

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1952, after the Texas Supreme Court denied a hearing.

1. During its fiscal year ended April 30, 1951, the petitioner incurred and paid substantial operating and drilling expenses in developing the property. The first question is whether those expenses accrued for income tax purposes in the year incurred and paid, as the courts below held, or only after final termination of the Mar-Tex litigation (December 1952, hence deductible in petitioner's 1952–1953 fiscal year). The asserted ground for postponing accrual of those expenses—that petitioner would have a right to reimbursement if Mar-Tex should prevail in its suit—is plainly insubstantial. Petitioner's liability to the persons performing the services was fixed and undisputed, while its right, should certain events occur, to obtain reimbursement from a third person was too contingent to be taken into account. Cf. *Dixie Pine Co.* v. *Commissioner*, 320 U.S. 516. In any event, there is no conflict. In *United States* v. *Consolidated Edison Co.*, 366 U.S. 380, the taxpayer had contested its own liability; the effect of a right over against a third party was not involved. In the other cases claimed to be in conflict (*e.g.*, *Levy* v. *Commissioner*, 212 F. 2d 522 (C.A. 5)), the right to reimbursement was not, as here, inchoate and contingent.

2. Petitioner paid the major part of the legal costs incurred on behalf of itself and the Burnetts in the Mar-Tex litigation. The second question is whether it was entitled to deduct those expenditures as business expenses. The Burnetts, as lessors, had covenanted the petitioner-lessee's quiet enjoyment of the property, and it seems evident that, as between the

two parties, the cost of defending the Mar-Tex suit was the responsibility of the Burnetts. As the courts below held, however, the expenditures would be non-deductible capital expenditures even if properly paid by the corporation. From the petitioner-lessee's point of view, the cost of defeating Mar-Tex's suit was the cost of perfecting its own leasehold or "working interest" which it had originally acquired with notice of Mar-Tex's claim of a prior right to the lease. And costs incurred in defending or perfecting title to property are nondeductible capital expenditures. Treas. Regs. 118 (1939 Code), § 39.23(a)-15(k).

Whether petitioner should be allowed to deduct the costs incurred specifically in the separate trial had to establish the expenses for which it would be entitled to reimbursement if Mar-Tex ultimately prevailed is less clear. That, however, was but a relatively unimportant part of the litigation and there are no facts in the record on which an apportionment of the costs between the two phases could be made.

The petition for certiorari should be denied.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
ROBERT N. ANDERSON,
CAROLYN R. JUST,
Attorneys,
Department of Justice,
Washington 25, D.C.

FEBRUARY, 1963.